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In the Supreme Court of the United States

OCTOBER TERM, 1978

TRANSAMERICA MORTGAGE ADVISERS, INC., ET AL., PETITIONERS

v.

HARRY LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION AS AMICUS CURIAE

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QUESTION PRESENTED

Whether there is a private right of action under Section 206 of the Investment Advisers Act of 1940.

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Securities and Exchange Commission is responsible for the administration and enforcement of

the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 *et seq.* The Commission's enforcement proceedings seeking to enjoin fraudulent practices of investment advisers are ordinarily "mild prophylactic" measures (*SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 193 (1963)) that generally do not provide redress to clients of advisers who are injured by fraud. The Commission therefore believes that a private right of action for damages and injunctive relief under Section 206 of the Act, 15 U.S.C. 80b-6, is necessary to protect such clients and to make effective the "federal fiduciary standards" (*Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977)) prescribed by Congress. Here, as elsewhere, private redress would serve as a "necessary supplement" to the Commission's own enforcement proceedings. *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 382 (1970); *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432 (1964).

STATEMENT

1. Respondent, a shareholder of petitioner Mortgage Trust of America ("Trust"), filed this suit in April 1973. The suit was brought as a derivative action on behalf of the Trust and as a class action on behalf of similarly situated shareholders. The complaint alleges that the Trust is a real estate investment trust within the meaning of Sections 856-858 of the Internal Revenue Code of 1954. The Trust was established to invest in a diversified portfolio of real estate mortgages, including construction and development mortgages, permanent first and junior mort-

gages, and certain equity interests in real estate (A. 4). At the time the action was commenced, approximately 3,382,000 shares of beneficial interest in the Trust were outstanding (A. 5). Petitioner Transamerica Mortgage Advisors, Inc. ("TAMA") is the investment adviser to the Trust and administers its day-to-day operations; the Trust is and always has been TAMA's only client (Pet. Br. 3). Petitioner Transamerica Corporation is the sponsor of the Trust and the parent of petitioner Transamerica Land Capital Inc. ("Land Capital"). Land Capital is the parent of TAMA, through a wholly-owned subsidiary, Transamerica Mortgage Company (Pet. Br. 3), which sold the Trust its original investment portfolio of mortgages (A. 29). The individual petitioners are trustees of the Trust (Pet. Br. 3). Several of these trustees have been affiliated with Transamerica Corporation, TAMA, or other subsidiaries of Transamerica Corporation (A. 6-7).

2. The complaint sets forth six claims. The first and fourth claims allege that the advisory contract between TAMA and the Trust is unlawful because TAMA and Transamerica Corporation have never registered under the Investment Advisers Act (A. 9). The complaint also alleges that TAMA and Transamerica Corporation have received grossly excessive compensation under the contract (A. 10). The second and fifth claims allege that TAMA and Transamerica Corporation caused the Trust to purchase securities from Land Capital. Those securities purchases are alleged to be the result of self-dealing and breach of

fiduciary duty, causing financial injury to the Trust (A. 14-16). The third and sixth claims allege that TAMA and Transamerica Corporation have withheld profitable investment opportunities from the Trust and have appropriated those opportunities for the benefit of other Transamerica affiliates (A. 17-18). The first three claims are stated derivatively on behalf of the Trust and against those responsible for the allegedly improper conduct. The other claims are pleaded on behalf of the class of the Trust's shareholders.

The complaint seeks injunctive relief to restrain further performance of the advisory contract; rescission of the advisory contract; restitution of fees and other consideration paid by the Trust; an accounting of illegal profits; and an award of damages (A. 20-21).

3. In March 1974 petitioners moved to dismiss the complaint. The district court granted the motion, concluding that "Section 206 * * * affords no private right of action" (A. 25). The court of appeals reversed, holding that "implication of a private right of action for injunctive relief and damages under the Advisers Act in favor of appropriate plaintiffs is necessary to achieve the goals of Congress in enacting the legislation" (A. 31). The court pointed out that the Fifth and Second Circuits have held that such actions may be maintained. See *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235 (5th Cir. 1978), petion for cert. pending, No. 77-1717; *Abrahamson* v. *Fleschner*, 568 F.2d 862 (2d Cir. 1977), cert. denied,

436 U.S. 913 (1978). Without repeating the discussion contained in *Abrahamson* and *Wilson*, the court of appeals in this case adopted the rationale of the majority in both of those cases.[1] Judge Wallace, in dissent, adopted the position of Judge Gurfein, who dissented in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 879-887.

Although petitioners argued that they were not subject to the provisions of the Investment Advisers Act, that respondent's class action claims were improper, and that a derivative action could not be maintained without a prior demand on the trustees,

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[1] A number of district courts previously had found that private plaintiffs may sue to enforce Section 206 of the Investment Advisers Act. See *Sullivan* v. *Chase Investment Services of Boston, Inc.*, 434 F. Supp. 171, 179 (N.D. Cal. 1977); *Fund of Funds, Ltd.* v. *Vesco*, [1976-1977] CCH Fed. Sec. L. Rep. ¶ 95,644 at 90,197-90,198 (S.D. N.Y. 1976); *Angelakis* v. *Churchill Management Corp.*, [1975-1976] CCH Fed. Sec. L. Rep. ¶ 95,285 at 98,463-98,464 (N.D. Cal. 1975); *Jones* v. *Equitable Life Assurance Society*, 409 F. Supp. 370, 373 (S.D. N.Y. 1975); *Bolger* v. *Laventhol, Kekstein, Horwarth & Horwarth*, 381 F. Supp. 260, 265, 268 (S.D. N.Y. 1974). See also *Kauffman* v. *Dreyfus Fund, Inc.*, 434 F.2d 727, 732-734 (3d Cir. 1970); *Gross* v. *Diversified Mortgage Investors*, 431 F. Supp. 1080, 1094-1095 (S.D. N.Y. 1977); *Fox* v. *Prudent Resources Trust*, 382 F. Supp. 81, 90-92 (E.D. Pa. 1974); *Young* v. *Seaboard Corp.*, 360 F. Supp. 490, 497 (D. Utah 1973); *Courtland* v. *Walston & Co., Inc.*, 340 F. Supp. 1076, 1082-1085 (S.D. N.Y. 1972). Two district courts have held that private remedies do not exist. See *Greenspan* v. *Del Toro*, [1975-1976] CCH Fed. Sec. L. Rep. ¶ 95,488 (S.D. Fla. 1974); *Gammage* v. *Roberts, Scott & Co., Inc.*, [1974-1975] CCH Fed. Sec. L. Rep. ¶ 94,761 (S.D. Cal. 1974). Those two decisions are of little effect because they are from circuits (the Fifth and Ninth) in which appellate opinions thereafter allowed private actions.

the court of appeals declined to consider those issues because the district court had not decided them (A. 30).

SUMMARY OF ARGUMENT

A private right of action for damages in favor of defrauded clients of an investment adviser is necessary to effectuate Congress' purpose in enacting Section 206 of the Investment Advisers Act, 15 U.S.C. 80b-6.

1. Respondent, the other shareholders and the Trust itself are among the class of persons for whose "especial benefit" (*Cort* v. *Ash*, 422 U.S. 66, 78 (1975)) the antifraud provision was enacted. Section 206, 15 U.S.C. 80b-6, prohibits fraud involving "any client" of an investment adviser. Congress sought to protect such clients "against malpractices by persons paid for advising others about securities." S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960). The decisions of this Court recognize that purpose. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191-201 (1963); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977).

2. Although the Investment Advisers Act does not explicitly authorize private suits, there is no indication that Congress intended to foreclose private relief. The omission of language expressly authorizing private actions is common to many antifraud provisions in the securities laws, yet there was unquestionably a congressional desire that remedies be available to eliminate fraudulent practices and to protect the

interests of clients of investment advisers. Congress has expressly provided that contracts and transactions in violation of the Act are void (Section 215, 15 U.S.C. 80b-15) and, as the court observed in the seminal decision with respect to implied remedies under Section 10(b) of the Securities Exchange Act, *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E.D. Pa. 1946), "a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it." See also *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 735 (1975).

3. A private right of action for damages is consistent with the purpose of Section 206. Private remedies would deter fraud and compensate injured clients. Such remedies also would be consistent with this Court's holding that the Act should be interpreted "not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC* v. *Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 195.

A private remedy here would not conflict with public enforcement of the statute. To the contrary, "congressional purposes are likely to be undermined absent private enforcement" (*Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25 (1977)). The Commission does not have the resources needed to police this industry, and injunctions obtained by the Commission are inadequate to protect the economic interests of defrauded clients. A private right of action is necessary to achieve the remedial purposes of Section 206, just as a private right of action is neces-

sary to achieve the purposes of Section 14(a) (see *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 431-435 (1964)) and Section 10(b) of the Securities Exchange Act of 1934 (see *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 730).

4. Congress' creation of a national system of regulation, and its intention "to establish federal fiduciary standards for investment advisers" (*Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11), demonstrate the inappropriateness of relying on state law to redress private losses of the kind involved here. The need to develop uniform federal standards, and to require investment advisers to conduct their business in compliance with the policies of Congress (*SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-201), weighs heavily against reliance on state law principles. At the time of enactment of the statute, Congress emphasized "that the solution of the problems and abuses of investment advisory services * * * cannot be effected without Federal legislation." S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940). Because the right asserted is "federal" in nature (*J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 434), "there is redress" in federal court "whatever might be available as a remedy under state law." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971).

5. A private remedy for violation of the antifraud provision of the Investment Advisers Act is consistent with this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*. Unlike the situation in

Blue Chip Stamps, where the plaintiff allegedly refrained from purchasing securities in reliance on false statements, a defrauded client is more than a mere "bystander" on the periphery of the securities markets; a "privity of dealing or even personal contact between potential defendant and potential plaintiff" is the rule, rather than the exception, in litigation under the Investment Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 745, 747. Thus, although Section 206 of the Investment Advisers Act does not contain a requirement that the fraud complained of be in connection with a purchase or sale of a security, the plaintiff class is limited to defrauded clients of the defendant adviser. Where the adviser engages in fraudulent practices that injure this class of beneficiaries, private rights of action may be recognized without danger of "liability in an indeterminate amount for an indeterminate time to an indeterminate class." 421 U.S. at 748.

ARGUMENT

A DEFRAUDED CLIENT OF AN INVESTMENT ADVISER MAY BRING SUIT UNDER SECTION 206 OF THE INVESTMENT ADVISERS ACT OF 1940

"[D]isregard of the command of [a] statute is a wrongful act, and where it results in damage to one of the class for whose especial benefit the statute was enacted, the right to recover the damages from the party in default is implied * * *." *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33, 39 (1916). See also

Tunstall v. *Brotherhood of Locomotive Firemen & Enginemen*, 323 U.S. 210, 213 (1944). These and many other decisions establish that courts ordinarily should grant remedies to private plaintiffs where "necessary to effectuate the congressional policy underpinning the substantive provisions of the statute." See *Bivens* v. *Six Unknown Named Agents*, 403 U.S. 388, 402 (1971) (Harlan, J., concurring).

This Court has repeatedly held that private persons may recover damages or obtain injunctions when they have been injured by violations of the provisions of the federal securities laws that were designed to protect persons situated similarly to the plaintiffs. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 433 ("it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose"); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 381-389 (1970); and *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 444 (1976) (recognizing implied rights of action under Section 14(a) of the Securities Exchange Act of 1934). See also *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 13 n.9 (1971); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 730 (1975); and *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 150-157 (1972) (recognizing implied rights of action under Section 10(b) of the Securities Exchange Act).[2]

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[2] Private rights of action have been recognized by the federal courts under the securities laws for more than thirty years. See *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512

Recent decisions of this Court have specified the considerations that govern whether courts should recognize a private right of action when the statute creating the substantive right is silent. See *Cort* v. *Ash*, 422 U.S. 66, 78 (1975) (citations omitted; emphasis by the Court):

> First, is the plaintiff "one of the class for whose *especial* benefit the statute was enacted"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?

This four-part test was applied by the Court in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), to determine whether a defeated tender-offerer could invoke an implied right of action under Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(e).[3]

(E.D. Pa. 1946), referred to by this Court as "the seminal decision" in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 730. See also *Fischman* v. *Raytheon Mfg. Co.*, 188 F.2d 783, 787 (2d Cir. 1951); *Goldstein* v. *Groesbeck*, 142 F.2d 422, 427 (2d Cir.), cert. denied, 323 U.S. 737 (1944).

[3] This Court concluded that a defeated tender-offeror should not have a private remedy because the tender-offeror was not the special beneficiary of that statute. *Piper* did not, however, rule out the possibility that a private action could be invoked

The Commission believes that, under the analysis set forth in *Piper* and *Cort*, private parties may obtain judicial relief for violations of Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6, and that clients of investment advisers are appropriate parties to vindicate these rights.[4]

A. The Trust And Its Shareholders Are Members Of The Class For Whose Especial Benefit The Investment Advisers Act Was Enacted

The literal text of Section 206, 15 U.S.C. 80b-6, demonstrates that its special beneficiaries are clients

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by "shareholder-offerees" (see 430 U.S. at 38-39 & n.25). Moreover, the Court reaffirmed the basic principle "that, where congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute." *Id.* at 25. See also *Regents of the University of California* v. *Bakke*, No. 76-811 (June 28, 1978), slip op. 13-14 n.28 (Stevens, J., concurring and dissenting).

[4] A number of cases that the Court will consider this Term present related questions concerning implied private remedies. See *Chrysler Corp.* v. *Brown*, No. 77-922, argued Nov. 8, 1978; *Cannon* v. *University of Chicago*, No. 77-926, argued Jan. 9, 1979; *Touche Ross & Co.* v. *Redington*, No. 78-309, cert. granted (Nov. 27, 1978); *Davis* v. *Passman*, No. 78-5072, cert. granted (Oct. 30, 1978); *Southeastern Community College* v. *Davis*, No. 78-711, cert. granted (Jan. 8, 1979). The government's briefs in *Chrysler* and *Cannon* employ the same method of analysis that is employed in this brief. (The United States did not file a brief in *Passman* and is considering whether to participate in *Touche Ross* and *Southeastern Community College*.)

of investment advisers.[5] The statute unambiguously prohibits frauds and courses of business that operate as frauds upon clients. This Court's decisions also emphasize that the purpose of Section 206 is to protect such clients from fraud and breaches of fiduciary duty. See *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-195; *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

At the time of the Act's passage, Congress recognized the importance of investment advisers and the necessity of protecting their clients from misfeasance. See S. Rep. No. 1775, 76th Cong., 3d Sess. 21 (1940)

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[5] In pertinent part, Section 206 provides:

> It shall be unlawful for any investment adviser * * * directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
>
> (3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. * * *
>
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. * * *

Section 206(4) was added to the statute in 1960. 74 Stat. 887. At that time Congress also extended the provisions of Section 206 to all investment advisers, whether or not such advisers were required to register under Section 203 of the Act. *Ibid.* Thus, the provisions of Section 206 apply to TAMA whether or not it is required to register, if it is an investment adviser (a question which, as noted, was not decided by the court below).

(stressing "the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors"); H.R. Rep. No. 2639, 76th Cong., 3d Sess. 28 (1940) (pointing out the need to protect clients "from the frauds and misrepresentations of unscrupulous tipsters and touts"); S. Rep. No. 1760, 86th Cong., 2d Sess. 1 (1960) (the purpose of the statute is to prevent "malpractices by persons paid for advising others about securities"). See also SEC, Report on Investment Trusts and Investment Companies, (Investment Counsel and Investment Advisory Services), H.R. Doc. No. 477, 76th Cong., 2d Sess. 27-30 (1939). Thus, just as purchasers and sellers of securities are the special beneficiaries of Section 10(b), 15 U.S.C. 78j(b), and shareholder-recipients of proxy solicitations are the special beneficiaries of Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a), an adviser's clients receive the special protections of Section 206 of the Investment Advisers Act. See *Abrahamson* v. *Fleschner*, 568 F.2d 862, 873 (2d Cir. 1977), cert. denied, 436 U.S. 913 (1978); *Wilson* v. *First Houston Investment Corp.*, 566 F.2d 1235, 1240-1241 (5th Cir. 1978), petition for cert. pending, No. 77-1717.[6]

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[6] The Investment Advisers Act gives legal protection to the sensitive fiduciary relationship (*SEC* v. *Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 191) that exists between an investment adviser and its clients. The Act "recognizes the personalized character of the services of investment advisers and especial care has been taken in the drafting of

B. There Is No Indication That Congress Intended To Foreclose Private Remedies

1. It is inherent in "implied cause of action" cases, such as the present one, that Congress was silent on the availability of private relief. The silence usually carries over to any jurisdictional statute that may accompany the substantive legislation in question. Thus jurisdiction over implied private rights of action often is supplied by 28 U.S.C. 1331, the general federal question jurisdiction statute. Things have been otherwise in most securities cases, because many securities laws contain jurisdictional provisions granting authority to decide actions at law. Section 214 of the Investment Advisers Act, 15 U.S.C. 80b-14, the provision that confers jurisdiction on the district courts to adjudicate claims of statutory violations and enjoin wrongdoing, differs from comparable provisions of the other securities laws because it omits reference to "actions at law."[7] Judge Gurfein, dissenting in

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the bill to respect this relationship." H.R. Rep. No. 2639, *supra* at 28. But Section 206 protects persons whose funds are managed on a collective basis as well as those persons who deal with their advisers on an individual basis. See S. Rep. No. 1775, *supra*, at 21 ("[T]he solution of the problems and abuses of investment advisory services—individuals and companies which either handle pools of liquid funds of the public or give advice with respect to security transactions—cannot be effected without Federal legislation"). The Trust in this case, which respondent seeks to represent derivatively, is a vehicle for the collective management of its shareholders' investments, and the protections of the Act extend to the shareholders themselves as well as the Trust.

[7] Section 214 of the Investment Advisers Act, 15 U.S.C. 80b-14, provides in relevant part:

> The district courts of the United States * * * shall have jurisdiction of violations of this subchapter or the rules,

Abrahamson v. *Fleschner*, *supra*, 568 F.2d at 881, cited this as evidence of congressional intent to foreclose damages actions under the Investment Advisers Act.[8] But the legislative history offers no support for the view that Congress omitted the "actions at law" phraseology in order to preclude private damages suits. If any inference can be drawn from the legislative history, it is that Congress did not focus on the issue of private remedies. See *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 875; *Wilson* v. *First Houston Investment Corp.*, *supra*, 566 F.2d at 1241-1242. See also *Cort* v. *Ash*, *supra*, 422 U.S. at 82-84; Comment, *Private Rights of Action under Amtrak and Ash*, 123 U. Pa. L. Rev. 1392, 1412 (1975).

Congress considered the Investment Advisers Act and the Investment Company Act of 1940 in tandem. The Investment Company Act was Title I, and the Investment Advisers Act Title II, of each of the bills

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regulations, or orders thereunder, and concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder.

Compare Section 22(a) of the Securities Act of 1933, 15 U.S.C. 77v(a); Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa; Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79y; Section 322(b) of the Trust Indenture Act of 1939, 15 U.S.C. 77vvv(b); and Section 44 of the Investment Company Act of 1940, 15 U.S.C. 80a-43.

[8] Judge Wallace, dissenting in the instant case, adopted Judge Gurfein's views (A. 32).

introduced in Congress.[9] The jurisdictional provision in Title II of the original bill (which ultimately became Section 214 of the Investment Advisers Act), incorporated by reference the jurisdictional provision contained in Title I. See S. 3580, 75th Cong., 3d Sess. Section 203 (1940); H.R. 8935, 76th Cong., 3d Sess. Section 203 (1940). The jurisdictional provision in Title I, in turn, incorporated by reference Section 25 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79y, which included the "actions at law" phraseology. See S. 3580, 76th Cong., 3d Sess. Section 40(a) (1940); H.R. 8935, 76th Cong., 3d Sess. Section 40(a) (1940).

After the hearings on the bill in the Senate, but before the hearings in the House, representatives of the investment advisory industry and the staff of the Commission met to discuss the bill. See S. Rep. No. 1775, *supra*, at 1. Judge Gurfein's dissenting opinion in *Abrahamson* points to these meetings and the resulting "compromise" that arose as an indication that the Act should be read more narrowly than other federal securities laws. *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 880. But the legislative history shows that no compromise affected the prohibition against fraud. As this Court has pointed out, the broad antifraud provision "remained in the bill from beginning to end." *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 191.

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[9] Although several versions of the Investment Advisers Act were proposed, the language in the House and Senate bills was identical at each stage.

Consideration of the relationship among Congress, the Commission and industry representatives in 1940 is useful in determining the nature of the compromises that were struck. In addition to questioning the necessity for federal regulation (*Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 76th Cong., 3d Sess. 745-746, 749-751 (1940) ("*Senate Hearings*")), industry representatives objected to provisions in the bill that required federal examination of investment counsel (*id.* at 746). Industry representatives also asserted that the investigatory powers granted to the Commission under the bill, if attended by publicity, could lead to a loss of confidence by clients (*id.* at 752). Senators Hughes and Wagner were quick to remind industry witnesses that their desire to avoid regulation must be weighed against Congress' duty to protect the public (*id.* at 753). Significantly, several industry representatives recognized that if additional regulation was called for, federal regulation was preferable to state regulation. See *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 88, 92 (1940) ("*House Hearings*"). Moreover, the President of the Investment Counsel Association assured members of the Senate Committee that the Association "strongly favor[ed]whatever method may be relied upon" to keep the profession "free from all forms of abuse." See *Senate Hearings, supra*, at 723; see also *id.* at 752. No member of the industry offered comments on the subject of remedies for defrauded clients.

The compromise version of the bill that received the endorsement of the industry took into account certain of its criticisms. The bill made no provision for examination of advisers prior to registration, reduced the amount of information to be disclosed in registration applications, and provided that investigations would be confidential. Industry representatives approved the bill with these changes. See *House Hearings, supra*, at 86-93.

The language that was enacted as the jurisdictional section of the Act (Section 214) first appeared in a committee print after the Senate Hearings. See Confidential Committee Print, S. 3580, 76th Cong., 3d Sess. Section 213 (1940). That version of the bill, and the version finally enacted into law, S. 4108, 76th Cong., 3d Sess. Section 214 (1940), both deleted the jurisdictional incorporations by reference, which had been used in earlier drafts, because the Investment Company Act and the Investment Advisers Act were designed to be independent and self contained. This change resulted at least in part because the investment adviser industry had indicated a preference for separation and restatement of each previously-overlapping provision of the two Acts. See *House Hearings, supra*, at 92, 137-138; *Senate Hearings, supra*, at 743.

Nothing in the legislative history explains why the final version of the jurisdictional provision in the Investment Advisers Act omitted reference to "actions

at law," while the jurisdictional provision in the Investment Company Act contained that reference. See S. 4108, 76th Cong., 3d Sess. Sections 44 and 214 (1940). Differences in the substantive provisions of the Acts may, however, suggest an answer. Section 30(f) of the Investment Company Act, 15 U.S.C. 80a-29(f), expressly created a private right of action for insider trading similar to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b). See S. 4108, 76th Cong., 3d Sess. Section 30(f) (1940). The Investment Advisers Act, in contrast, contained no provision expressly creating a private remedy, and this may account for the difference in the jurisdictional provisions. But the difference does not support an inference that Congress meant to forbid private actions to enforce the substantive rules of the Investment Advisers Act.[10] It shows, at most, that Congress did not affirmatively provide for such actions. And that fact is quite neutral.

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[10] Although there was no contemporaneous explanation of the difference, those provisions were discussed in the House and Senate Committee Reports. Section 214, together with Sections 208-221 of the Investment Advisers Act, 15 U.S.C. 80b-8 to 80b-21 ("the administrative and enforcement machinery" of the statute), were described as being "generally comparable" to the corresponding provisions in the Investment Company Act. See S. Rep. No. 1775, *supra*, at 23; H.R. Rep. No. 2639, *supra*, at 30. Congress' view that the jurisdictional provision in the Investment Advisers Act is generally comparable to that in the Investment Company Act discredits the notion that Congress intended to permit private relief under one statute and not the other.

2. Judge Gurfein's dissenting opinion in *Abrahamson* also relied on the doctrine "that when a statute limits a thing to be done in a particular mode, it includes the negative of any other mode" (568 F.2d at 882), pointing out that Section 214 of the Investment Advisers Act authorizes only "equitable relief." From this he reasoned that although a private remedy for equitable relief may be acknowledged, a private damages remedy is foreclosed (*id.* at 882 n.8). This argument is wrong for two reasons: first, it would obliterate all implied private rights of action, and second, it erroneously assumes that Section 214 would be the source of the private remedy.

Unless the statute is silent on the question, there is no need to consider whether a private remedy should be implied to enforce a substantive right. But such silence almost always takes place in the context of the provision of some remedies. For example, the Court has concluded that there is a private right of action to enforce Section 10(b) of the Securities Exchange Act of 1934 even though nothing in Section 10(b) expressly creates such a right, and even though other portions of the Act create express private rights of action to enforce other substantive rules.[11] See *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 729-730. Judge Gurfein's rigorous application of the "expressio unius exclusio alterius" maxim would require the overruling of almost all of the

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[11] See Sections 9(e), 16(b), and 18 of the Securities Exchange Act of 1934, 15 U.S.C. 78i(e), 78p(b), 78r.

cases in which this Court recognized implied private rights of action. But there is no need to do so, because the maxim never has been carried to the full extent of its logic. The Court always has examined the legislative history of the substantive statute to determine whether Congress *intended*, in providing one remedy, to foreclose others. When the examination discloses such an intent, it is appropriate to apply only the remedies specifically enumerated.[12] See, *e.g.*, *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412, 420-421 (1975). But when the legislative debates or the structure of the statute do not disclose such an intent, it is appropriate to apply the prevailing rule that private remedies are available to enforce substantive rights given to private parties. See, *e.g.*, *Allen* v. *State Board of Elections*, 393 U.S. 544, 556-557 (1969). The "expressio unius exclusio alterius" approach adds little of value: the Court must divine the legislative plan statute-by-statute. *Cort* v. *Ash*, *supra*, 422 U.S. at 83 n.14.

At all events, Judge Gurfein was wrong in applying an "expressio unius exclusio alterius" approach to Section 214, because that Section does not create remedies or indicate what the appropriate remedies would be. It is a jurisdictional provision, and it supplements the general jurisdictional provision of 28

[12] See also pages 32-36 and 53-55 of the government's brief in *Chrysler Corp.* v. *Brown*, No. 77-922, argued Nov. 8, 1978, which applies this principle in arguing that neither 18 U.S.C. 1905 nor the Freedom of Information Act, 5 U.S.C. 552, supports a private right of action to enjoin disclosure of information by federal agencies.

U.S.C. 1331 by removing the amount-in-controversy requirement of the latter statute. Section 214 expresses, at best, the view of Congress that injunctive actions (but not damages actions) under the Investment Advisers Act should be entertained without regard to the amount in controversy.[13]

The substantive right in question comes from Section 206 of the Investment Advisers Act, not from Section 214. Section 206 establishes a duty but does not explicitly provide for any remedy, public or private, in equity or at law. It simply creates the right to be enforced. The statute creating the right—which has always been the critical provision in considering whether courts should recognize a private claim for relief[14]—thus does not support Judge Gurfein's position.

[13] It is clear that 28 U.S.C. 1331 provides jurisdiction to entertain implied private rights of action. See *Bell* v. *Hood*, 327 U.S. 678, 682-684 (1946); *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 424; *Bivens* v. *Six Unknown Named Agents*, *supra*, 403 U.S. at 405 (Harlan, J., concurring). Cf. *Texas & Pacific Ry.* v. *Rigsby*, *supra*, 241 U.S. at 39-40. The courts of appeals that have recognized private rights of action under the Investment Advisers Act have relied on Section 1331 as the ground of jurisdiction. See A. 32 n.2; *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 875 n.22; *Wilson* v. *First Houston Investment Corp.*, *supra*, 566 F.2d at 1237 n.2.

[14] See, *e.g.*, *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 431-433 (looking principally to the content of the substantive right even though also relying on 15 U.S.C. 78aa, which gives courts jurisdiction of controversies "at law" in certain securities matters); *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 424.

3. Although Section 214 of the Act thus does not support an inference that Congress intended either to authorize or to forbid private damages remedies under the Investment Advisers Act, Section 215(b) of the Act, 15 U.S.C. 80b-15(b), which provides for avoidance of illegal contracts, "strongly suggests" that a private right of action is consistent with the intentions of Congress.[15] *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 874; *Sullivan* v. *Chase Investment Services of Boston, Inc., supra,* 434 F. Supp. at 182. Indeed, Professor Loss has remarked that private remedies are "perhaps more express than implied" when the statute contains such a voidability rule. III L. Loss, *Securities Regulation* 1758-1759 (2d ed. 1961). Accord, *Kardon* v. *National Gypsum Co., supra,* 69 F. Supp. at 514: "a statutory enactment that a contract of a certain kind shall be void almost necessarily implies a remedy in respect of it." See also *Blue Chip Stamps*

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[15] Section 215(b) provides in pertinent part:

> Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void * * * as regards the rights of any person who, in violation of any such provision, rule, regulation, or order, shall have made or engaged in the performance of any such contract * * *."

Under this provision, an adviser's sale of securities to a client would be voidable if the sale violated the antifraud provision of the Investment Advisers Act. An advisory contract illegal under the Act also would be subject to avoidance.

v. *Manor Drug Stores, supra,* 421 U.S. at 735. This means, at a minimum, that equitable proceedings for rescission, restitution, and injunctive relief are available.[16] Equitable remedies of this nature would provide the relief sought by respondent. This complaint seeks an injunction, rescission, restitution, and an accounting—all traditional forms of equitable relief.[17] Moreover, proceedings for injunctions, rescission and restitution have always encompassed monetary relief where necessary to do equity. See *Porter* v. *Warner Holding Co.,* 328 U.S. 395, 399 (1946); *Wyandotte Transportation Co.* v. *United States,* 389 U.S. 191, 204 (1967). See also 6A A. Corbin, *Contracts* 833, 834 (1962); 5 *id.* at 573, 574 (1964); D. Dobbs, *Remedies* 618-619, 631 (1973).[18]

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[16] Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 882 n.8, acknowledges that "implication of a private right of action for rescission and restitution under § 215(b) would be well within the jurisdictional grant of § 214, and consistent with the notion that it is only *actions at law* which are inconsistent with the statutory scheme" (emphasis in original).

[17] Equitable remedies sought by private parties under the securities laws are, of course, subject to the traditional prerequisites. *Rondeau* v. *Mosinee Paper Corp.,* 422 U.S. 49, 59-63 (1975).

[18] A suit by a client seeking damages from an investment adviser has certain similarities to a surcharge proceeding brought by a beneficiary against a trustee. The surcharge proceeding is wholly equitable in nature, but monetary relief is routinely granted where a breach of fiduciary duty has caused injury to the trust corpus. See, *e.g.,* III *Scott on Trusts* §§ 199, 205-213 (3d ed. 1967); see also *McClintock on Equity* § 85 (2d ed. 1948). The application of such equitable prin-

4. Petitioners argue that Congress' failure expressly to create a private remedy in 1970 when amendments to the Investment Advisers Act were considered supports the inference that Congress intended to forbid all private remedies (Pet. Br. 17-20). That contention is incorrect.

In 1970 Congress amended both the Investment Advisers Act and the Investment Company Act. It expressly authorized private actions against investment advisers under Section 36(b) of the Investment Company Act, 15 U.S.C. 80a-35(b). Congress was well aware of the possibility that this might be cited —as petitioners have cited it—for the proposition that other rights are foreclosed. The legislative history refutes that proposition, however, because both committees stated that the creation of an express right of action under Section 36(b) should not be interpreted to affect other implied remedies. See S. Rep. No. 91-184, 91st Cong., 1st Sess. 16 (1969); H.R. Rep. No. 91-1382, 91st Cong., 2d Sess. 38 (1970).

In 1975 the Commission submitted a proposal to Congress that would amend Section 214 to extend jurisdiction, without regard to the amount in controversy, to "actions at law" under the Act. See S. 2849, 94th Cong., 2d Sess. Section 6 (1976). That proposal also was intended to confirm the existence

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ciples is, of course, appropriate in a federal action. *Hecht Co.* v. *Bowles*, 321 U.S. 321, 329-330 (1944). Whether or not an action can be brought in state court against an adviser is a separate question, as is its efficacy. See the discussion at pages 35-41, *infra*.

of private rights of action to enforce the Act's substantive rules. See *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 17 (1976); *Hearings on H.R. 12981 and H.R. 13737 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce*, 94th Cong., 2d Sess. 36-37 (1976). The Senate Committee reported favorably on the provision as proposed by the Commission. The Committee agreed with the lower court decisions holding that private remedies may be implied under Section 206, pointing out that it would be "anomalous" to deny private remedies to advisory clients when investors may invoke implied remedies under other securities statutes. S. Rep. No. 94-910, 94th Cong., 2d Sess. 8-9 (1976). Although the bill did not come to a vote in either house, there is no indication that Congress would have rejected the Commission's proposal.[19]

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[19] Petitioners also argue that Congress' efforts in 1960 to strengthen the Investment Advisers Act in several respects, including the enforcement powers of the Commission, indicate a desire to preclude private remedies (Pet. Br. 17-18). But the legislative history does not mention that issue, and it is odd to contend that an amendment to strengthen enforcement silently disapproved private actions. Three years prior to the 1960 amendments, the Commission had taken the position that the existing language of Sections 206 and 214 was sufficient to support a private damages action in favor of a defrauded client. Brief for the SEC as *amicus curiae*, *Hull* v. *Newman, Kennedy & Co.*, Civ. Action No. 118-283 (S.D. N.Y., filed Sept. 10, 1957). It was not until several years later, after some uncertainty arose in the district courts, that

In sum, the recent activities of Congress do not suggest an intention to foreclose private remedies. Those activities are entirely consistent with the view that a private remedy may be implied. Petitioners' "excursion into extrapolation of legislative intent [is] entirely unilluminating." *Cort* v. *Ash*, *supra*, 422 U.S. at 83 n.14.

C. Private Remedies Are Consistent With The Underlying Purpose Of The Statute And Necessary to Achieve The Goals of Congress

1. The principal purpose of the Investment Advisers Act was to eliminate abuses by investment advisers that caused injury to both their clients and the national economy. *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 186-187. The legislative history repeatedly emphasizes protection of clients from unscrupulous and fraudulent practices. See, *e.g.*, H.R. Rep. No. 2639, *supra*, at 28; S. Rep. No. 1775, *supra*, at 21-22; 86 Cong. Rec. 2844-2845 (1940) (remarks of Sen. Wagner). Although Congress had enacted many securities antifraud provisions prior to the Investment Advisers Act, it concluded in 1940 that more effective remedies were needed. Thus, in describing existing securities statutes, Rep. Wolverton pointed out that:

> The Securities Act of 1933 and the Securities Exchange Act of 1934 have not been effectual in

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the Commission sought clarification of the language of Section 214. *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 17 (1976).

> preventing the type of abuses that have grown up in the investment field. These acts merely provide for publicity. This, however, has not provided adequate security to the investing public.

86 Cong. Rec. 9816 (1940). Congress' solution to the problem of unscrupulous investment advisers was the creation of federal fiduciary standards. See *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

Private remedies available to defrauded clients of investment advisers would do much to achieve the purposes of the statute. The availability of damages for violations of the provisions of Section 206 would encourage ethical behavior by advisers. Although the "deterrent value" of private litigation can never be "ascertained with precision" (*Piper* v. *Chris-Craft Industries, Inc.*, *supra*, 430 U.S. at 40), the prospect of effective private redress for fraudulent conduct certainly would have some deterrent effect. By awarding damages to remedy injuries suffered by the special beneficiaries of the Act, moreover, the federal courts would create an enforcement mechanism "closely tailored to the precise congressional goal." *Ibid.* Protection of the economic interests of clients is the very point of the prohibition against adviser fraud.[20]

The availability of private remedies would not conflict with public enforcement or undermine other

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[20] See the remarks of Rep. Wolverton, 86 Cong. Rec. 9815 (1940), stressing the need "to save the investor from the losses that were incident to doing business with those who were not actuated by honest motives." See also *Senate Hearings*, *supra*, at 320.

statutory goals. This case is therefore quite different from *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453, 458-463 (1974) (*"Amtrak"*). The legislative history of the statute involved there showed that Congress intended to foreclose a private remedy; moreover, private suits would have delayed railroad discontinuances and thus frustrated achievement of a statutory goal. Similarly, in *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 420-425, the Court concluded "that the overall structure and purpose of the SIPC scheme are incompatible with such an implied right." *Id.* at 421. *Barbour* did not, however, question the appropriateness of private remedies under the federal securities laws, pointing out that private remedies had been implied "[i]n light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes * * *." *Id.* at 423.

Petitioners rely heavily on *Amtrak* and *Barbour*, but they do not come to grips with the essential distinction between private actions (such as those in *Amtrak* and *Barbour*) that might frustrate the legislative plan and those (such as in this case) that might help to carry out the plan. More than that, petitioners slight the fact that the plaintiffs in both *Amtrak* and *Barbour* sought relief that was identical to relief that public officials were authorized to seek, but which, for reasons of public policy, they had fore-

sworn.[21] In each case, the private plaintiffs were seeking the aid of the judiciary to achieve an objective that was at cross-purposes with decisions made by the responsible administrative agency.[22] But the com-

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[21] The fact that administrative agencies have not invoked available remedies is not, however, a sufficient reason to forbid private actions. As the government's brief in *Cannon* v. *University of Chicago*, *supra*, emphasized, it is important to consider whether the administrative remedy would produce the relief available in a suit. In *Cannon*, for example, an administrative process might lead to a suspension of funding for private institutions that discriminated on account of sex, but it might not effectively produce relief for individual victims of discrimination. A private remedy therefore could supplement the administrative process and would not undermine it. The same is true here.

[22] In *Amtrak*, for example, Congress gave to the Attorney General alone the authority to bring suit, principally in order to eliminate delays that had grown up under earlier legislation. The Attorney General's decision not to bring a suit would represent his judgment that discontinuation of service was appropriate, and the decision would clear the way for discontinuation. The allowance of private litigation would recreate the delay sought to be eliminated and, in the process, call into question the Attorney General's decision that discontinuation of service was not contrary to the public interest (414 U.S. at 462-464). Cf. *Morris* v. *Gressette*, 432 U.S. 491, 504-505 (1977). In *Barbour* the plaintiff had sought to require SIPC to initiate a proceeding for the liquidation of a broker-dealer. The statute provided that the Commission could seek to compel such action by SIPC, if SIPC refused to do so itself. The Court pointed out that Congress had named SIPC as the appropriate party to begin liquidation proceedings for insolvent broker-dealers because that was an extraordinary remedy and because its intervention might precipitate a dealer's collapse. Congress had chosen the Commission to supervise SIPC's obligation. To allow a parallel action by a private party to compel SIPC to intervene might unnecessarily

plaint in this case does not seek relief that the SEC would prefer be withheld. Indeed, the complaint seeks relief—private restitution of sums alleged to be wrongfully taken—that would not ordinarily be available in a suit brought by the Commission. The private action here therefore is a prototypical case of the suit that supplements the Commission's actions by adding deterrence of future wrongs and restitution for private harms to the prospective remedies available at the Commission's request. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432.

Such supplementation is essential. The growth of the investment advisory industry since passage of the Advisers Act has been substantial. In the fiscal year that ended June 30, 1941, there were 753 advisers registered under the new Act. SEC, *Seventh Annual Report* 31 (1942). In the fiscal year that ended September 30, 1977, 4,823 persons were registered with the Commission as investment advisers. SEC, *43rd Annual Report* 234 (1979). The Commission's records show that the number of registrants increased to 5,385 as of December 31, 1978. As of June 30, 1969, registered advisers had more than $130 billion of assets under advisement. SEC, Institutional Investor Study Report, H.R. Doc. No. 92-64, 92d Cong., 1st Sess. 139 (1971). In its most recent budget submission to the Congress, for the fiscal year ended October

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cause a dealer to collapse at a time when SIPC or the Commission still believed that the dealer could be saved. *Securities Investor Protection Corp.* v. *Barbour*, *supra*, 421 U.S. at 420-423.

30, 1980, the Commission estimated that the assets currently under advisement by registered advisers totalled $200 billion. The Commission's examination and enforcement capabilities have not grown proportionately. In 1977 the Commission was able to conduct only 459 inspections of investment advisors. SEC, *43rd Annual Report* 234 (1979). The Commission believes that here, as in *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 432, the magnitude of the enforcement problem requires private litigation by persons in a position to learn the facts about particular advisers and bring them to the court's attention. The effectiveness of the Act "would be 'severely hampered' without the existence of a private remedy to supplement administrative procedures." *Regents of the University of California* v. *Bakke*, *supra*, slip op. 14 n.28 (Stevens, J., concurring and dissenting).

2. Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 883, maintained that private enforcement is inconsistent with the statutory scheme because the Investment Advisers Act was designed as "a compulsory census of investment advisers, and not as a pervasive regulatory scheme." We question whether the "pervasiveness" of the regulatory scheme has much to do with the desirability of private enforcement. The essential question is whether there is a substantive federal rule and, if so, how that rule should be enforced. This Court therefore has acknowledged the propriety of implied rights of action "where congressional purposes are likely to be undermined absent private en-

forcement * * *";[23] or where there exist "standards of conduct that a private action could help to enforce * * *";[24] or where such actions will help to prevent "harm * * * of the type that the statute was intended to forestall * * *,"[25] as well as where there is "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard."[26] The issue in every case is whether the remedy serves the purposes inherent in the statutory scheme. To determine that issue, one must examine the legislature's objectives. As we have discussed, the Investment Advisers Act was intended by Congress to protect clients from the fraudulent devices of advisers; the implication of a private remedy is wholly consistent with that scheme and acts as a necessary supplement to the Commission's enforcement of the statute. *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432.

At all events, Judge Gurfein's view that the Investment Advisers Act merely provides for a "compulsory census" fails to take into full account the substantive provisions of the statute. The Act requires most persons who render investment advice for

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[23] *Piper* v. *Chris Craft Industries, Inc., supra,* 430 U.S. at 25.

[24] *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 424.

[25] *Wyandotte Transportation Co.* v. *United States, supra,* 389 U.S. at 202.

[26] *Cort* v. *Ash, supra,* 422 U.S. at 82.

compensation to register with the Commission and to disclose information concerning their methods of operation (Section 203, 15 U.S.C. 80b-3). Registered advisers must submit to inspections and maintain books and records concerning their operations (Section 204, 15 U.S.C. 80b-4). The contracts of advisers are subject to regulation (Section 205, 15 U.S.C. 80b-5), and certain persons are excluded from becoming advisers (Section 203(e), 15 U.S.C. 80b-3(e)). The Act contains a sweeping anti-fraud provision (Section 206, U.S.C. 80b-6) and provides for administrative injunctions and criminal penalties (Sections 209(e), 217, 15 U.S.C. 80b-9(e), 80b-17).[27] This scheme may be less "pervasive" than the one applicable to registered broker-dealers (see Securities and Exchange Act of 1934, Section 15, 15 U.S.C. 78*o*), but there can be no doubt that Congress has established a detailed regulatory scheme for the protection of advisory clients, and that the statute is far more than a mere "census taking" mechanism.

D. Regulation Of Investment Advisers Has Not Been A Traditional Concern Of The States, And Defrauded Clients Should Not Be Remitted to State Law Remedies

The final factor to be considered in determining whether the structure and purpose of a statute sup-

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[27] The Commission also has broad rule-making authority under the Act. See 15 U.S.C. 80b-3(c)(1), 80b-4, 80b-5, 80b-6(4), 80b-6a, 80b-10(a), and 80b-11. The Commission has adopted rules regulating, *inter alia,* the records to be kept by advisers, the use of performance fee contracts, the contents of advertising, and the safekeeping of clients' funds and securities. See 17 C.F.R. 275.204-2, 275.204-3, 275.205-1, 275.205-2, 275.206(4)-1 and 275-206(4)-2.

port private remedies is whether the subject is "one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law." *Cort* v. *Ash*, *supra*, 422 U.S. at 78. See also *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, 430 U.S. at 40; *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 478-479.

It is beyond question that Congress found state supervision inadequate and intended to create federal standards to govern the conduct of investment advisers.[28] When the statute was enacted, there was no scheme of regulation in 42 of the 48 states. See *Senate Hearings*, *supra*, at 96-1004. Representatives of the investment advisory industry themselves acknowledged the absence of adequate state regulation and called for a uniform system of federal regulation. See *House Hearings*, *supra*, at 88, 92. The Act thus created, as this Court has recognized, a new federal standard of fiduciary duty. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11.

Although state regulation of investment advisers has become more common since passage of the Act, "[s]tate controls with respect to conduct in the investment advisory field are of extremely limited scope

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[28] See S. Rep. No. 1775, *supra*, at 21: "[P]rotection of investors requires the regulation of investment advisers on a national scale. * * * [T]he problems and abuses of investment advisory services * * * cannot be effected without Federal legislation. * * * Virtually no limitations or restrictions exist with respect to the honesty and integrity of individuals who may solicit funds to be controlled, managed, and supervised."

and significance * * *." See SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. 374 (1963). The most recent survey conducted by the Commission indicates that 17 jurisdictions still have no registration requirements for advisers, and 19 jurisdictions have no examination, qualification, capital, or bonding requirements. See *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 19-23 (1976); Ahart, *Suggested Amendments to the Investment Advisers Act*, 6 Sec. Reg. L.J. 226, 229-234 (1978). Moreover, most state statutes were enacted after and patterned on the federal statute. See Note, *Private Causes of Action Under Section 206 of the Investment Advisers Act*, 74 Mich. L. Rev. 308, 324 & n.103 (1975). The federal government remains the primary regulator of investment advisers, and enforcement of federal standards will not supersede an established body of state law.

Petitioners nonetheless contend that claims of the kind presented in this case are traditionally relegated to state law (Pet. Br. 25-27). They rely on the ability of a trust's beneficiaries to sue trustees for breach of fiduciary duty. Petitioners argue that this branch of "the common law offers a formidable arsenal of precedents, presumptions and remedies" (Pet. Br. 28). But that merely states the obvious. This Court has recognized repeatedly that the antifraud provisions of the federal securities laws regulate conduct previously

regulated by the common law. See *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 195 ("Congress codified the common law 'remedially'" under the Investment Advisers Act); see also *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 744. As one commentator has noted, the federal antifraud provisions derive from the common law and are superimposed on it. III Loss, *Securities Regulation*, *supra*, at 1430, 1435. But Congress enacted federal statutes precisely because common law remedies had proved to be inadequate, and the existence of such state remedies therefore is not important here. See *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 434-435; *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 12 ("there is redress under § 10(b) whatever might be available as a remedy under state law").[29] See also *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 461-463 (1969); *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 210-212 (1967); *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959).

At all events, the common law is not as helpful to clients of investment advisers as petitioners imply. Most of the state cases cited by petitioners involve the construction of testamentary trusts, the beneficiaries

[29] In many cases now brought under Section 10(b) the aggrieved purchaser or seller of securities (alleging both scienter and deception) could have brought an action under common law principles of deceit. But the availability of state law tort remedies has not precluded implication of private remedies under Section 10(b).

of which are usually limited in number and familiar to the testator. See, *e.g.*, *In re Estate of McLaughlin*, 43 Cal. 2d 462, 274 P.2d 868 (1954); *In re Ridings' Estate*, 297 N.Y. 417, 79 N.E.2d 735 (1948); *In re Estate of Van Deusen*, 37 App. Div. 2d 131, 322 N.Y.S. 2d 951 (1971).[30] Although many investment advisers handle substantial amounts of their clients' funds, the principles developed in the cases cited by petitioners have no direct relevance in actions brought against those investment advisers who sell advice or financial analysis and do not manage their clients' portfolios. Moreover, application of state law standards to investment advisers may result in conflicting interpretations and divergent standards of duty.[31]

[30] State trust law principles often have proved to be inadequate to protect the interests of participants in large investment trusts. See, *e.g.*, *Hazzard* v. *Chase National Bank of City of New York*, 159 Misc. 57, 287 N.Y.S. 541 (Sup. Ct. 1936), aff'd, 282 N.Y. 652, 26 N.E.2d 801 (1940) ("I am reluctantly constrained to conclude that the defendant has successfully exempted itself from liability in this sad picture of high finance. For the inexcusable terms of the indenture, the trustee cannot be held accountable. It performed in full the negligible duty which was imposed upon it * * *. It did nothing more, but, having done that, it is absolved under the law") (287 N.Y.S. at 572). The inadequacy of state law principles of fiduciary duty was the very reason for enacting the Trust Indenture Act, 15 U.S.C. 77aaa *et seq.*, the Investment Company Act, 15 U.S.C. 80a-1 *et seq.*, and the Investment Advisers Act, 15 U.S.C. 80b-1 *et seq.*

[31] Compare *Barnes* v. *Peat, Marwick, Mitchell & Co.*, 69 Misc. 2d 1068, 332 N.Y.S. 2d 281 (Sup. Ct. 1972), modified on other grounds, 42 App. Div. 2d 15, 344 N.Y.S. 2d 645 (1973)

In these circumstances, this Court's observations in *Borak* are most pertinent: "[I]f federal jurisdiction were limited * * * victims [of fraud] would be obliged to go into state courts for remedial relief. And if the law of the State happened to attach no responsibility to the use of [the fraudulent device], the whole purpose of the section might be frustrated" (377 U.S. at 434-435).

In light of Congress' decision to create federal fiduciary standards, it would be anomalous for federal courts to relegate defrauded clients to state law remedies. See *Wilson* v. *First Houston Investment*

(right of action implied for violation of "blue sky" antifraud provision in favor of broker's client) with *Herdegen* v. *Paine, Webber, Jackson & Curtis*, 31 Misc. 2d 104, 220 N.Y.S. 2d 459 (Sup. Ct. 1961) (state court refuses to recognize a private right of action in favor of a customer who received fraudulent advice under either common law or state "blue sky" antifraud provision); see also *Jones Memorial Trust* v. *Tsai Investment Services, Inc.*, 367 F. Supp. 491, 498 (S.D. N.Y. 1973) (no right of action under state law where registered investment adviser is not the stock broker in a fraudulent transaction); *Twomey* v. *Mitchum, Jones & Templeton, Inc.*, 262 Cal. App. 2d 690, 697-720, 69 Cal. Rptr. 222, 229-243 (1968) (state remedy exists if violations of Securities Exchange Act of 1934 are found); *Miller* v. *Livingstone*, 25 App. Div. 2d 106, 267 N.Y.S. 2d 249, aff'd, 18 N.Y. 2d 967, 278 N.Y.S. 2d 206 (1966) (falsity of financial statement and misrepresentation of qualifications are insufficient to state a right of action for fraud); see also *Koos* v. *Ludwig*, 22 App. Div. 2d 666, 253 N.Y.S. 2d 380 (1964); *Brown* v. *Bullock*, 35 Misc. 2d 370, 230 N.Y.S. 2d 660 (Sup. Ct.), aff'd, 17 App. Div. 2d 424, 235 N.Y.S. 2d 837 (1962); *Levine* v. *Silverman*, 43 Misc. 2d 415, 251 N.Y.S. 2d 68 (Sup. Ct. 1964); Note, *The Regulation of Investment Advisers*, 14 Stan. L. Rev. 827, 832-834 (1962).

Corp., *supra*, 566 F.2d at 1242-1243; *Sullivan* v. *Chase Investment Services of Boston, Inc.*, *supra*, 434 F. Supp. at 184; cf. *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 191-192. Closing the doors of the federal courts to claims of fraud would increase the possibility that investment advisers with clients in many different states (advisers who themselves advocated uniform federal regulation) would be subject to divergent state law standards of duty. Congress' creation of a uniform system of regulation weighs heavily against such a result.[32]

E. Private Remedies Under The Act Are Consistent With *Blue Chip Stamps*

Judge Gurfein's dissenting opinion in *Abrahamson* v. *Fleschner*, *supra*, 568 F.2d at 884, expressed concern about creation of an "open-ended" private right of action and suggested that a private right of action to enforce Section 206 would conflict with the purchaser-seller standing requirement of *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*. That reasoning fails to take into account the essential difference between Section 206 of the Investment Advisers Act

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[32] Reliance on state law principles to resolve the issues raised by this complaint would be most inappropriate. The complaint charges that the advisory contract is void for failure to comply with the registration requirements of the federal Act. It also alleges self-dealing transactions and misappropriation of investment opportunities violative of the antifraud provision of the Act. These allegations should be analyzed under the express terms and policies of the Act, not under common law principles.

and Section 10(b) of the Securities Exchange Act: Section 206 safeguards the fiduciary relationship between investment advisers and their clients, while Section 10(b) protects the integrity of securities transactions and securities markets, extending to anonymous buyers and sellers on exchanges who have no other relationship to each other. *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 471 n.11; *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 728.

In *Blue Chip Stamps* the Court considered the consequences of the express statutory limitation in Section 10(b) that the fraud be "in connection with the purchase or sale of any security." 421 U.S. at 733. There could be no private damages remedy without a purchase or sale. The same form of analysis, applied here, demonstrates that Judge Gurfein's concern is unwarranted. Subsections (1), (2) and (4) of Section 206, 15 U.S.C. 80b-6(1), (2) and (4), proscribe fraudulent practices of investment advisers even if they do not occur in connection with securities transactions. The omission of a purchase or sale requirement in subsections (1), (2) and (4) cannot be deemed to be inadvertent, particularly in light of the fact that subsection (3) contains such a requirement.[33] See *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 734.

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[33] Section 206(3), 15 U.S.C. 80b-6(3), which concerns purchases or sales of securities for a client's account by an investment adviser acting as a principal or broker for the account of another person, expressly relates to purchase or sale transactions.

The prohibition in Section 206 of fraudulent practices, even when not in connection with a securities purchase or sale, reflects the recognition that the devices employed by investment advisers to defraud their clients may have little direct relationship to specific securities transactions. For example, a customer may be defrauded when an adviser receives compensation on the basis of false promises of large profits. See *SEC* v. *C. R. Richmond & Co.*, 565 F.2d 1101, 1106 (9th Cir. 1977); *Marketlines, Inc.* v. *SEC*, 384 F.2d 264, 266 (2d Cir. 1967), cert. denied, 390 U.S. 947 (1968). Similarly, clients may be defrauded when an adviser falsely promises to guarantee them against losses. See *SEC* v. *Seipel*, [1952-1956] CCH Fed. Sec. L. Rep. ¶ 90,735 (D. D.C. 1954), aff'd, 229 F.2d 758 (D.C. Cir. 1955). An adviser who conceals his insolvency or precarious financial condition from clients also has acted fraudulently. See *Intersearch Technology, Inc.*, [1974-1975] CCH Fed. Sec. L. Rep. ¶ 80,139 at 85,189 (SEC 1975). And fraud may occur when an adviser secretly misuses the funds of his client for personal benefit. See *Steadman Security Corp.*, [1977-1978] CCH Fed. Sec. L. Rep. ¶ 81,243 at 88,339-5 to 88,339-8 (SEC 1977), appeal pending, No. 77-2415 (5th Cir.).

The absence of a purchase or sale limit to the scope of Section 206 does not mean, however, that private actions will threaten open-ended liability or unmanageable judicial problems. Because Section 206 must be understood in light of the legislative purpose to protect the fiduciary relationship between client and adviser (*SEC* v. *Capital Gains Research Bureau, Inc.*,

supra, 375 U.S. at 191), it has its own limits on the scope of liability. The statute presupposes the existence of a relationship of financial trust or reliance between the defendant and the plaintiff. That effectively limits the number of potential plaintiffs and rules out unforeseen liabilities to the general public. A "privity of dealing or even personal contact between potential defendant and potential plaintiff" would be the rule in any action under the Investment Advisers Act. *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 745, 747. See also *Reserve Management Corp.* v. *Anchor Daily Income Fund, Inc.*, [1978] CCH Fed. Sec. L. Rep. ¶ 96,566 at 94,371 (S.D. N.Y. 1978).

The clients of an adviser are a determinable class; they are often personally known by the adviser and their reliance on the adviser's honesty is clearly foreseeable. Cf. *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. at 151-154. Moreover, defrauded clients will be entitled to damages only "to the extent that they can be shown." See *Mills* v. *Electric Auto-Lite Co.*, *supra*, 396 U.S. at 389.[34]

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[34] There are doubtless a number of open questions concerning the necessary elements of a private right of action. *Cf. SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 194; *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976). The courts below did not reach any such issues. This Court need decide only whether a remedy should be implied, as in *J. I. Case Co.* v. *Borak*, *supra*, 377 U.S. at 431-435. Any questions concerning the elements of the claim and the appropriate limits of relief should be left for consideration in the first instance by the lower courts. Cf. *SEC* v. *National Securities, Inc.*, *supra*, 393 U.S. at 465.

In sum, because the duty of the adviser to his clients is well established, and because the plaintiff class is limited to persons who are entitled to rely on the faithful performance of that duty, private suits for damages are well suited to help enforce the substantive rules that Congress has prescribed.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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